IN THE SUPREME COURT OF TEXAS

NO. 96-0079

THOS. D. MURPHY, JR., RAY HAWKINS, TRUDI HESTAND, AND TRACY HAWKINS, INDIVIDUALLY AND ON BEHALF OF COLONIAL FOOD STORES, INC. AND HAWKINS-ROCHESTER-MURPHY, INC. AND THE BANKRUPTCY ESTATE OF LOUIS ROCHESTER, INTERVENOR, PETITIONERS

v.

ROBERT CAMPBELL, RORY MCLAUGHLIN, JOE FLECKINGER & CHUCK SCHMIDT, INDIVIDUALLY AND D/B/A AGENTS FOR DELOITTE & TOUCHE, A PARTNERSHIP, FORMERLY KNOWN AS TOUCHE ROSS & CO., A PARTNERSHIP, AND AS AGENTS FOR TOUCHE ROSS & CO., AND TOUCHE ROSS & CO., RESPONDENTS

ON APPLICATION FOR WRIT OF ERROR TO THE COURT OF APPEALS FOR THE THIRD DISTRICT OF TEXAS

Argued on September 5, 1996

JUSTICE SPECTOR, joined by JUSTICE ABBOTT, and joined in Part I by JUSTICE ENOCH, dissenting.

Thirty years ago, this Court held that a taxpayer's malpractice cause of action against an accountant accrues when the taxpayer knows or should know that he or she has been *actually* injured and the tort complained of is complete. *Atkins v. Crosland*, 417 S.W.2d 150 (Tex. 1967). Today the Court holds, in effect, that an accounting malpractice cause of action accrues when a taxpayer knows or should know of a *mere risk* of injury, before any actual injury has occurred. Because the Court misapplies *Atkins*, and because this case should also be controlled by the tolling rule of *Hughes v. Mahaney & Higgins*, 821 S.W.2d 154 (Tex. 1991), I dissent.

I.

Malpractice requires legal injury as an element of the cause of action. *Peeler v. Hughes & Luce*, 909 S.W.2d 494, 496 (Tex. 1995) (malpractice cause of action arises only when there has been a breach of duty that proximately causes damages). In *Atkins*, this Court held that the taxpayer's

cause of action against his accountant for malpractice arose, not when the accounting error was committed, but when the Commissioner of Internal Revenue assessed a deficiency against the taxpayer. 417 S.W.2d at 153. This was so because the taxpayer took no further action to contest the deficiency. Consequently, actual injury resulted and the tort was complete. *Id*.[1]

In tax cases, where disputing the amount of tax liability is routine,[2] there is no legal injury until the tax dispute is resolved. *Atkins* held that the cause of action arises when a deficiency is assessed, not because that particular stage of a tax liability dispute has special significance, but because that is when the deficiency is determined in that particular case. When the assessment is no longer in dispute, the existence of an injury can then be determined, an essential element of the malpractice cause of action. *See Atkins*, 417 S.W.2d at 153-54 (citing a similar rule in *Linkenhoger v. American Fidelity & Cas. Co.*, 260 S.W.2d 884 (Tex. 1953)).

In this case, it was the judgment of the tax court that determined whether there would be liability, thus completing the tort. *See Peat, Marwick, Mitchell & Co. v. Lane*, 565 So. 2d 1323 (Fla. 1990) (holding that when the accountant did not acknowledge error, the limitations period commenced when the tax court entered its judgment). Here, the plaintiffs suffered no actual injury upon receiving the notice of deficiency.[3] Rather, the deficiency notice made the plaintiffs aware of a mere risk of harm: the possibility that Touche Ross *may* have committed malpractice that could result in damages. Actual injury, however, occurs only when the taxpayer, due to the accountant's malpractice, accepts the IRS's assessment, negotiates a settlement, or exhausts appeal in the courts.

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[1] The majority's use of *Atkins* in its discovery rule discussion is particularly inappropriate as the *Atkins* opinion does not even mention the rule. __ S.W.2d at __.

[2] Challenging deficiency notices from the IRS is such a routine part of doing business and paying taxes that the IRS itself allows the costs to be deducted. *See, e.g.,* Rev. Rul. 92-29, 1992-1 C.B. 20 (allowing a deduction for the costs of resolving asserted tax deficiencies of a sole proprietor's business); *see also* Earl C. Gottschalk, Jr., *Fighting Uncle Sam: Weigh the Costs and Probable Benefits of Your Claim Before Taking on the IRS*, WALL ST. J., Mar. 8, 1991, at R24.

[3] The IRS's notice of deficiency in this case, which the Court holds triggered the accrual of the plaintiffs' cause of action, differs significantly from the final assessment in *Atkins*. Penalties may not be assessed until either ninety days after the notice, if the taxpayer does not sue in tax court, 26 C.F.R. § 301.6213-1(a)(2), or after final judgment in the tax court or court of appeals. 26 U.S.C. § 7481(a). If the IRS is prohibited from assessing penalties, it is difficult to see how an injury triggering a cause of action for malpractice could have occurred.

By holding that the plaintiffs' cause of action accrued when they became aware of a risk of harm rather than when they became aware of an actual injury, the Court misapplies *Atkins* in a particularly ill-advised way. Essentially, the Court holds that a plaintiff can "discover" an injury before the injury occurs and before "the tort complained of [is] completed." *Atkins*, 417 S.W.2d at 153. This holding runs contrary not only to common sense but also to our established jurisprudence on the statute of limitations.[4] Under the Court's view, a taxpayer could sue for malpractice, and then prevail in the underlying tax dispute, proving that there was no actual injury in the first place. Further, by forcing taxpayers to sue their accountants before it is possible to determine whether a wrong has been committed, the Court's decision will have the practical effect of encouraging needless litigation and wasting valuable court resources on suits that will ultimately be abandoned. *See International Engine Parts, Inc. v. Feddersen & Co.*, 888 P.2d 1279, 1287 (Cal. 1995); *United States Nat'l Bank v. Davies*, 548 P.2d 966, 970 (Or. 1976).

II.

The Court errs also by narrowing our holding in *Hughes*.[5] 821 S.W.2d 154. Under *Hughes*, limitations are tolled on a legal malpractice claim until resolution of the underlying litigation in which the attorney may have breached a duty. The reasons for this rule are twofold. First, as the Court acknowledges today, the plaintiff should not be forced to take inconsistent positions, arguing in the malpractice suit that the attorney acted negligently at the same time the client's self-interest requires supporting the attorney's actions in the underlying suit. *See Peat, Marwick*, 565 So. 2d at 1326. Second, "[l]imitations are tolled for the second cause of action because the viability of the second cause of action depends on the outcome of the first." *Hughes*, 821 S.W.2d at 157.

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[4] I take issue with those courts of appeals that have substituted a "risk of harm" requirement for an actual harm requirement. *See Ponder v. Brice & Mankoff*, 889 S.W.2d 637, 642-43 (Tex. App.--Houston [14th Dist.] 1994, writ denied); *Hoover v. Gregory*, 835 S.W.2d 668, 673 (Tex. App.--Dallas 1992, writ denied); *Zidell v. Bird*, 692 S.W.2d 550 (Tex. App.--Austin 1985, no writ). This Court has consistently reiterated that the plaintiff must know or have reason to know of the wrongful act and *actual injury* to trigger limitations under the discovery rule. *See S.V. v. R.V.*, 933 S.W.2d 1, 4 (Tex. 1996); *Trinity River Auth. v. URS Consultants, Inc.*, 889 S.W.2d 259, 262 (Tex. 1992) ("the cause of action is deemed not to accrue until the injury becomes discoverable").

[5] While JUSTICE ENOCH does not join in Part II, he agrees that the Court misreads *Hughes*.

The applicability of *Hughes* to this case goes beyond the inconsistent positions problem. Although *Hughes* was an attorney malpractice action, accounting malpractice involving tax advice is similar to legal malpractice for limitations purposes, as the majority acknowledges. ___ S.W.2d at ___ (citing *Willis v. Maverick*, 760 S.W.2d 642 (Tex. 1988)). The majority fails to acknowledge, however, that the concerns behind the decision in *Hughes* apply with equal force to the case at bar. The plaintiffs in this case had to hire another accounting firm during the tax court proceedings, just as the plaintiffs in *Hughes* would have been forced to obtain new counsel in the underlying lawsuit after filing a malpractice action against their original attorney.

Further, the Court suggests that the plaintiffs in this case could have filed and abated the malpractice action during the pendency of the tax court action. That suggestion could have applied equally to the plaintiffs in *Hughes*, but we rejected it as overly burdensome on the plaintiffs and inconsistent with the discovery rule's purposes. In addition, to do so would allow the malpractice cause of action to accrue before the merits of the underlying claim are determined. In essence, plaintiffs are forced to sue before their claim is ripe. *See City of El Paso v. Madero Dev.*, 803 S.W.2d 396 (Tex. App.--El Paso 1991, writ denied). Taxpayers who rely on an errant accountant's advice to pursue a dispute through the lengthy tax court appeals process might have no cause of action if the statute runs from the notice of deficiency, as the majority would have it. *See Peat, Marwick*, 565 So. 2d 1323.

Because all of the justifications for the attorney-malpractice rule in *Hughes* apply equally to accounting malpractice, the Court is unjustified in limiting *Hughes* to the facts of that case. The Court's holding today not only refuses to extend *Hughes*, but it severely restricts that decision's application. Because of the similarities between legal malpractice and accounting malpractice, and their potential for overlap, I would hold that even if a tort cause of action has accrued, the statute of limitations is tolled during the pendency of the tax liability dispute. This holding would have prevented the plaintiffs from being forced into inconsistent positions in the two cases and allowed the plaintiffs to determine before suing if they had been wronged.

III.

Statutes of limitations balance competing interests: giving potential plaintiffs a reasonable time to present their claims while fixing a point beyond which potential defendants can rest assured that they will not be sued for past actions. By holding that a cause of action for accounting malpractice accrues, at the latest, when the plaintiff receives a notice of tax deficiency, the Court has upset that balance. Because the Court forces accounting malpractice plaintiffs to sue before they have been actually injured and to take inconsistent positions in the underlying litigation, I dissent.

Rose Spector
Justice

OPINION DELIVERED: December 11, 1997